



# **State of Washington Office of Insurance Commissioner**

**Mike Kreidler, Insurance Commissioner**

## **A Report to the Legislature Regarding the Impact of Creating Guaranty Fund Protection for Workers' Compensation Policies**

**Submitted By: The Office of Insurance Commissioner  
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## **Executive Summary**

During the 2004 legislative session, the Insurance Brokers and Agents of the West (IBAW) submitted SB 6158, which sought to create a separate account within the Washington Insurance Guaranty Association to cover United States Longshore and Harbor Workers' Compensation Act insurance (USL&H). The Legislature amended the bill to require a broader guaranty fund study. As enacted, ESB 6158 directs the Insurance Commissioner to study: the impact and effectiveness of covering USL&H insurance under the Washington Insurance Guaranty Association; and the impact of excluding from guaranty association protection workers' compensation policies purchased on the commercial market by tribes and tribal employers, and by employments identified in RCW 51.12.020 (hereinafter referred to as "optional categories").

In June 2004, the Insurance Commissioner created two workgroups to study the issues identified in ESB 6158. The workgroups, which were composed of OIC representatives and interested stakeholders, met from June to November.

### ***USL&H Insurance***

The USL&H workgroup concluded that a new account should be created in the Washington Insurance Guaranty Association to cover USL&H insurance. In reaching this conclusion, the workgroup considered, among others, the following key factors:

- The importance of the maritime industry to the Washington State economy and the potential impact of a USL&H carrier insolvency;
- The likelihood that Kemper, a major writer of USL&H coverage in Washington, will become insolvent in the near future; and
- The final regulations being promulgated by the United States Department of Labor (DOL), which will require all insurers writing USL&H in states without guaranty fund coverage to post full security for their USL&H business in that state.

The workgroup examined the funding mechanism for a separate USL&H account and concluded that the account should be funded by a pre-insolvency assessment that continues post-insolvency, and the fund should not be permitted to grow beyond a set limit. Additionally, member insurers should be granted a premium tax offset for the guaranty fund assessment. The Insurance Commissioner's recommendations are consistent with the workgroup's conclusions.<sup>1</sup>

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<sup>1</sup> The USL&H workgroup was divided on the method by which insurers should be permitted to recoup guaranty fund assessments. The Insurance Commissioner's recommendation is consistent with one of the approaches considered by the workgroup.

## ***Tribal Workers' Compensation Insurance and Workers' Compensation Insurance for "Optional Categories"***

The workgroup that studied tribal workers' compensation insurance and workers' compensation insurance for "optional category" employments determined that no action should be taken at this time to provide guaranty fund protection for these types of insurance. However, the workgroup also concluded that guaranty fund coverage for tribal workers' compensation merits further consideration and should continue to be studied during 2005.

In reaching these conclusions, the workgroup considered the following key factors:

- The impact of the 2003 Legion and Villanova insolvencies on the tribal workers' compensation market in Washington;
- Hudson Insurance Company is the only insurer that offers first-dollar tribal workers' compensation coverage in Washington, and Hudson opposes participation in a guaranty association;
- The Title 51 "optional category" employers can voluntarily purchase industrial insurance from the State;
- Many of the "optional category" employers who decline to purchase industrial insurance purchase a combination of disability, life and health insurance in lieu of workers' compensation, and disability and life insurance are already covered under the Washington Life and Disability Insurance Guaranty Association.

# Introduction

## **ESB 6158**

In 2004, the Washington State Legislature enacted ESB 6158<sup>2</sup>, relating to the Washington Insurance Guaranty Association. This act directs the Insurance Commissioner to study and develop recommendations relating to the following:

- The impact and effectiveness of covering United States Longshore and Harbor Workers' Compensation Act<sup>3</sup> insurance under the Washington Insurance Guaranty Association.
- The impact of excluding from guaranty association protection workers' compensation policies purchased on the commercial market for employments identified in RCW 51.12.020.
- The impact of excluding from guaranty association protection workers' compensation policies purchased on the commercial market by tribes and tribal employers.

The act directs the Commissioner to report the results of the study to the legislature.

## ***The study***

In late June, the Commissioner convened two workgroups to study the issues outlined in ESB 6158. The first workgroup addressed issues relating to coverage of United States Longshore and Harbor Workers' Compensation Act insurance under the Washington Insurance Guaranty Association. The second workgroup examined the impact of excluding from guaranty fund coverage tribal workers' compensation insurance and insurance for Title 51 "optional categories." Both workgroups met seven times between June and November.

The USL&H workgroup membership included representatives from the Insurance Commissioner's Office, Labor and Industries, USL&H insurers (Liberty Northwest, SeaBright, and PointSure), maritime employers (Todd Shipyards), insurance agents and brokers (IBAW), organized labor, the Washington Insurance Guaranty Association, and the Washington USL&H Assigned Risk Plan.<sup>4</sup> Additionally, the workgroup consulted with representatives from the U.S. Department of Labor and Western Guaranty Fund Services.

Membership of the tribal workers' compensation and "optional categories" workgroup included representatives from the Insurance Commissioner's Office, Labor and Industries, AWB, insurance agents and brokers (IBAW, Brown & Brown), organized labor (the Joint Council of Teamsters), tribal employers (Tulalip Casino, Muckleshoot Indian Tribe and Skagit Valley Casino), insurers (AIG), and the Washington Insurance Guaranty Association.<sup>5</sup> The workgroup also consulted with a representative from Hudson Insurance Company.

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<sup>2</sup> [http://www.leg.wa.gov/pub/billinfo/2003-04/Senate/6150-6174/6158\\_sl\\_04052004.txt](http://www.leg.wa.gov/pub/billinfo/2003-04/Senate/6150-6174/6158_sl_04052004.txt)

<sup>3</sup> 33 U.S.C. Sec. 901 et seq.

<sup>4</sup> See Appendix A.

<sup>5</sup> See Appendix A.

## Insurance Guaranty Associations in Washington

Washington State currently has two insurance guaranty associations--a property and casualty insurance guaranty association and a life and disability insurance guaranty association.

In 1971, the Legislature passed the Washington Insurance Guaranty Association Act.<sup>6</sup> The Washington Insurance Guaranty Association, which covers property and casualty insurance, has two separate accounts: (1) The automobile insurance account; and (2) the account for all other insurance covered under the act. Currently, the Washington Insurance Guaranty Association covers claims arising from “all kinds of direct insurance, *except* life, title, surety, disability, credit, mortgage guaranty, workers’ compensation and ocean marine insurance.”<sup>7, 8</sup>

The Legislature also created the Washington Life and Disability Insurance Guaranty Association in 1997.<sup>9</sup> This guaranty association covers claims arising from policies or contracts of life and disability insurance and annuity contracts.<sup>10</sup>

The purpose of a guaranty association is to protect policyholders and other claimants from the uncertainty of whether and when their claims will be paid in the event that their insurer becomes insolvent.

The operation of a guaranty association is strictly controlled by statute. When an insurer is placed into liquidation due to insolvency, claims for policy benefits and claims for the return of unearned premiums are referred directly to the appropriate guaranty association for consideration and payment. In most cases, claim payments begin within 90 days after the order of liquidation is filed.

The Washington liquidation statute terminates all property and casualty policy coverage 30 days after the date of liquidation. However, life insurance policies, disability policies and annuities are usually kept in force because age and insurability make replacing the coverage very expensive or even impossible. For these policies, the guaranty associations of the various states involved work together to find a buyer for the business and transfer the obligations to a solvent insurer.

Most authorized insurance companies are required to belong to the state guaranty associations that cover the lines of business the companies write. The associations’ operations are funded through post-insolvency assessments from solvent member insurance companies, based upon the amount of premiums written.

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<sup>6</sup> The Washington Insurance Guaranty Association Act is codified in chapter 48.32 RCW.

<sup>7</sup> RCW 48.32.020 (emphasis added)

<sup>8</sup> See Appendix B--2004 summaries, by provision, of property and casualty insurance guaranty association acts of the various states and U.S. territories, prepared by the National Conference of Insurance Guaranty Funds.

<sup>9</sup> The Washington Life and Disability Insurance Guaranty Association Act is codified in chapter 48.32A RCW. This chapter was originally adopted in 1971, but was repealed and replaced with the existing chapter 48.32A RCW in 2001.

<sup>10</sup> RCW 48.32A.025

# **United States Longshore and Harbor Workers' Compensation Insurance**

## ***Background***

The United States Longshore and Harbor Workers' Compensation Act<sup>11</sup> is a federal law that requires maritime employers to carry a specialized type of workers' compensation coverage or self-insure their risk. Although the Act initially applied to maritime workers on the water, it was amended in 1972 to cover maritime workers on land adjacent to navigable waters.

In Washington, employers must purchase USL&H coverage from commercial insurers or must self-insure. USL&H insurance is not available through the Washington Industrial Insurance Fund (Labor and Industries).

## **U.S. Department of Labor Special Fund**

The United States Longshore and Harbor Worker's Compensation Act is administered by the DOL. Under the Act, a Special Fund to address claims for second injuries was created.<sup>12</sup> The DOL finances the Special Fund with assessments. Every authorized underwriter of USL&H, including self-insured employers, is assessed on the basis of claim payments.

Under the Act, the obligation to pay benefits to injured workers is the responsibility of the employer.<sup>13</sup> The employer is required to either insure such obligations, or receive permission from the DOL to self-fund.<sup>14</sup> If an employer insures its risks, the obligation to pay benefits passes from the employer to the insurer. In the event the insurer becomes insolvent and is unable to pay claims, the obligation to pay benefits shifts back to the employer. Although the Special Fund was created to address claims for second injuries, in the event an insurer becomes insolvent and there is no employer or the employer becomes insolvent or is in imminent danger of becoming insolvent, at the discretion of the DOL, the Special Fund may be used to cover unpaid claims.

## **U.S. Department of Labor Regulations**

The DOL believes that there has been a continued, accelerating trend toward guaranty fund pullback in the states and is concerned that there may be inadequate guaranty fund coverage for USL&H. According to the DOL, 75% of the national USL&H market is written in the top 15 USL&H insurers. Given the risks inherent in writing USL&H coverage, and the limited market size, the DOL believes that action is required to ensure that USL&H claims in the future are paid in case of insurer insolvency.

In March 2004, the DOL published a notice of proposed rulemaking relating to revision of the regulations governing certain aspects of the administration of the United States

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<sup>11</sup> 33 U.S.C. Sec. 901 et seq.

<sup>12</sup> 33 U.S.C. Sec. 908(f)

<sup>13</sup> 33 U.S.C. Sec. 904

<sup>14</sup> DOL requires an employer to post security to self-fund its USL&H obligations.

Longshore and Harbor Workers' Compensation Act.<sup>15,16</sup> The DOL expects to publish the final regulations by the end of 2004, and they will be effective in early 2005.

Under the proposed regulations, the DOL will require all insurers writing USL&H in states without guaranty fund coverage to post full security for their USL&H claim liabilities in that state. The security posted by an insurer will be used by the DOL to cover that insurer's defaulted claims in the case of insolvency.

The DOL will not require an insurer to post security if a guaranty fund that fully covers USL&H claims exists in the state. If, however, a state has a guaranty fund that only partially covers USL&H claims (i.e., a limit less than the statutory maximum is placed on claims), the DOL will evaluate each insurer's outstanding risks and will require the insurers to post partial security.

The security required under the proposed regulations must be either a cash deposit in an authorized bank, a security bond, or a letter of credit from an acceptable bank.

The DOL acknowledges that in states without guaranty fund coverage, the new security requirement will be a heavy burden and could cause USL&H insurers without a large book of business to leave those states.

## ***History in Washington***

The Washington Insurance Guaranty Association was created in 1971, but expressly excluded coverage for workers' compensation insurance. Efforts were made in the late 1970's to cover USL&H insurance under the guaranty association, but attempts to change the law failed in the Legislature.

In 2003, Fremont Indemnity, a major writer of USL&H insurance, failed. In addition, another major USL&H insurer currently is under supervision in another state and the company's long-term outlook is in doubt. These two events have rocked the Washington market and have again raised the question of whether USL&H should receive guaranty fund protection.

In June 2003, Fremont Indemnity was placed under conservation. The company went into liquidation on July 2, 2003. At the time of the insolvency, a number of large claims were outstanding, including claims relating to the November 1999 shooting at the Northlake Shipyard at Lake Union. In the absence of a guaranty fund, those claims not paid out of the liquidated assets of the insurer will become the responsibility of the insured employers.

In 2003, Kemper came under the supervision of the Illinois Department of Insurance. It is widely assumed by the insurance industry that given Kemper's financial status, the company may fail in the foreseeable future. In the normal course of business, Eagle Pacific, a

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<sup>15</sup> 20 C.F.R. Parts 701 and 703

<sup>16</sup> <http://frwebgate5.access.gpo.gov/cgi-bin/waisgate.cgi?WAISdocID=801762173600+0+0&W AISaction=retrieve>



Washington domiciled USL&H insurer acquired by Kemper, ceded all business to its parent company. The assets of Eagle Pacific and renewal rights to the USL&H book of business were subsequently purchased by SeaBright Insurance Company. However, SeaBright did not assume any of Eagle Pacific's pending claims and reserves--those are retained by Kemper. If Kemper goes into liquidation, the outstanding claims remaining from the Eagle Pacific transaction will lack funding. At last report, the estimated dollar amount of these uncovered claims in Washington is approximately \$12.5 million.<sup>17</sup>

During the 2004 legislative session, IBAW<sup>18</sup> submitted SB 6158<sup>19</sup>, which would have created a separate USL&H account within the existing Washington Insurance Guaranty Association. Many questions were raised about the concept, including the funding mechanism. Ultimately, the Legislature amended the bill to require the study on which this report is based.

### ***Issues Raised by Workgroup***

- What is the size of the USL&H market in Washington?
- What is the importance of the maritime industry to Washington?
- What is the potential impact of future USL&H insurer insolvencies in the absence of a guaranty fund?
- If a USL&H guaranty fund is created:
  - ❖ Should it be created in a separate guaranty fund? Or, instead, should it be created in a separate account within the existing fund?
  - ❖ What claims should be covered under the guaranty fund?
  - ❖ How should a USL&H guaranty fund be financed?

### **Size Of the USL&H Market in Washington**

Based on information gathered by the Insurance Commissioner's Office, more than \$23 million of direct premiums were written in Washington State for USL&H policies by the top 15 insurers in the state writing workers' compensation insurance. Of the top 15 insurers writing workers' compensation insurance in Washington in 2003, only ten write USL&H insurance. The workgroup estimates that the total annual USL&H premium currently written in Washington is approximately \$30 million.

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<sup>17</sup> Based on information from Kemper, the estimated dollar amount of the total outstanding reserves in Washington is approximately \$18 million.

<sup>18</sup> Insurance Brokers and Agents of the West

<sup>19</sup> <http://www.leg.wa.gov/pub/billinfo/2003-04/Senate/6150-6174/6158.pdf>

## **Importance of the Maritime Industry in Washington**

The maritime industries are integral to the Washington State economy and way of life. The Puget Sound region is the second largest handler of container ship traffic in North America. Approximately one quarter of the jobs in Washington State are related to trade and the maritime and fisheries industries.<sup>20 21</sup>

Many of the large maritime employers in Washington self-insure, rather than purchase USL&H coverage on the commercial market. Of the smaller employers that do purchase commercial USL&H coverage, Todd Shipyards is one of the largest with approximately 1,000 employees.

The workgroup heard from representatives of Todd Shipyards and Puglia Engineering concerning the importance of having USL&H coverage and the impact of insurer insolvencies on their businesses. Puglia Engineering is much smaller than Todd Shipyards with approximately 150 employees.

In order to conduct business on vessels or on land adjoining the water, employers must have USL&H coverage. Many employers are required to obtain USL&H insurance, even though their main business focus is not maritime-related. Businesses that provide equipment to, and support for the maritime industry may need this coverage for their employees who have incidental contact with maritime businesses. Contractors doing work on maritime sites may also need this coverage for their employees engaged in such work.

Under the United States Longshore and Harbor Workers' Compensation Act, when a USL&H insurer is insolvent, the outstanding claims become the responsibility of the employer. This can have a profound impact on a small maritime business. When Fremont Indemnity failed in 2003, Todd Shipyards had to assume \$2.5 million in claims from Fremont.

## **Potential Impact of Future USL&H Insurer Insolvencies**

The impact of future USL&H insurer insolvencies in Washington could be significant in the absence of a guaranty fund to cover the claims. Only a small number of companies write USL&H in Washington. Both Fremont, through its Industrial Indemnity subsidiary, and Kemper, through its Eagle Insurance Group subsidiary, were major writers of USL&H in Washington. With Fremont's insolvency, employers were forced to assume the liability for all outstanding claims, including a number of claims that occurred in the 1980's.

Beginning in 2005, DOL regulations will require insurers to post full security for all USL&H risks located in the state, unless a guaranty fund is created by the Legislature. Without a

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<sup>20</sup> Odyssey Maritime Discovery Center, 2003

<sup>21</sup> Examining just the state's largest port--the Port of Seattle--the economic impact is widespread and significant. In 2003, the Port supported 34,501 direct and indirect jobs, producing \$2.1 billion in wages and \$2.4 billion in revenue. The Port's nearly \$6 billion in exports in 2003 touched all corners of the state. While the three largest export items were inorganic chemicals (\$522.9 million), beef, pork and poultry (\$434.6 million), and oilseeds (\$402.3 million), the Port also exported significant amounts of paper (\$179.3 million), grain (\$145 million), apples (\$59.2 million) and aluminum (\$54.7 million). <http://www.portseattle.org>

guaranty fund to cover USL&H claims, insurers with a small USL&H book of business may leave the state rather than post full security for their risks. The result will be a shrinking of an already small voluntary USL&H market.

Although the remaining insurers will have posted security with the DOL for their risks, if that security is inadequate to cover all of the claims, the remaining claims will become the responsibility of the employers. Additionally, because Kemper is already under the supervision of the Illinois Department of Insurance and the company could become insolvent before the DOL regulations are enacted, the regulations will not ensure that security is available to cover Kemper's outstanding claims in Washington.

In the event of a USL&H insurer insolvency for which inadequate security has been posted, or if Kemper fails, the claims will become the responsibility of the maritime employer. The DOL's Special Fund may cover the claims, but only if the employer is placed in imminent danger of going insolvent, or has gone insolvent. Because of the recent failure of Fremont Indemnity, which resulted in claims being shifted to maritime employers, if Kemper were to fail in the near future or if another insurer were to fail without adequate security to cover the claims, the cumulative negative impact on the maritime industry in Washington would be significant.

### **Creating a USL&H Guaranty Account in Washington**

Based on the potential negative impact of another USL&H insurer insolvency on the maritime industry in Washington and the pending DOL final regulations that will require a posting of full security, the workgroup determined that USL&H insurance should receive guaranty fund protection in Washington.

Washington has two separate guaranty associations. In deciding whether to create a third guaranty association or to cover USL&H under an account within the Washington Insurance Guaranty Association (WIGA), the workgroup considered both the administrative costs and time required to set up a new association. Creating guaranty fund coverage for USL&H insurance within the existing association would be less costly and time consuming than starting with a new association.

The workgroup briefly discussed whether USL&H insurance could be included in the WIGA account that covers "all other" property and casualty insurance.<sup>22</sup> The group dismissed the idea for a number of reasons. The risks covered by the lines of insurance in the "all other" property and casualty account differ significantly from the risks covered by USL&H insurance. Property and casualty insurers that do not write USL&H insurance would be asked to cover guaranty claims on a product line they do not write. Additionally, the "all other" property and casualty account has a maximum per claim limit of \$300,000, which would not constitute "full coverage" under a guaranty fund so as to exempt USL&H insurers from DOL's requirement of posting full security.

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<sup>22</sup> The Washington Insurance Guaranty Association Act is codified in RCW 48.32.010 et seq.

The workgroup determined that a separate, third account should be created in WIGA. The account would cover only USL&H insurance.<sup>23</sup> WIGA's Board of Directors supports the concept of creating a third account for USL&H. The account should be administered separately from the other two accounts and be funded from assessments of admitted USL&H insurers only.

To avoid the requirement of posting security for USL&H risks in Washington and to be prepared in the event of a Kemper insolvency, the guaranty account must be created during the 2005 legislative session.<sup>24</sup>

## **Covered Claims Under a USL&H Guaranty Account**

The big issue for the workgroup related to the scope of the covered claims. With the possibility of a Kemper insolvency on the horizon, and the possibility of \$12.5 million in claims from Kemper, the workgroup considered whether a USL&H guaranty account should be created in such a way as to ensure coverage of these claims. The workgroup considered the negative impact that a Kemper insolvency would have on the maritime industry in Washington, and determined that claims arising from a Kemper insolvency should be covered.

Kemper is currently under the supervision of the Illinois Department of Insurance and an insolvency, if it happens, likely would not occur until after January 1, 2005. The workgroup therefore determined that a USL&H guaranty account should cover all claims arising from any insurer insolvency that occurs after January 1, 2005.

The workgroup also considered whether a maximum limit should be placed on the payment of claims, and determined that such a limit was not desirable. With rare exception, the various state guaranty funds for workers' compensation cover all statutory claim obligations. The workgroup determined that a USL&H guaranty account should cover all statutory obligations established under the United States Longshore and Harbor Workers' Compensation Act.

## **Financing a USL&H Guaranty Account**

### **Pre-insolvency assessment**

The issue of funding includes both the timing of the assessment and the amount of the assessment. The workgroup determined that a USL&H guaranty account should be funded with a pre-insolvency assessment that continues post-insolvency. Additionally, based on actuarial analysis by IBAW representatives, the workgroup determined that the insurers

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<sup>23</sup> No other state has a separate guaranty fund or account dedicated exclusively to USL&H insurance.  
<http://www.ncigf.org>

<sup>24</sup> Beginning in January 2005, the DOL expects to require all carriers in states without USL&H guaranty fund coverage to provide documentation of their financial data from which the DOL will calculate the individual security requirements. The DOL expect that carriers will not be required to post the security until July 2005. If guaranty fund coverage is in effect prior to the date on which security must be posted, the carriers will be able to avoid the requirement.

should be assessed prior to any insolvency at an annual rate of up to 3% of their net direct written premium for the year prior to assessment. Thereafter, insurers should be assessed at a rate to be determined by the WIGA board of directors, but not to exceed an annual rate of 3% of the net direct written premium. The post-insolvency assessment should continue until all financial obligations are satisfied and until a maximum fund deemed appropriate by the board of directors has been created.

The vast majority of guaranty funds in the United States are financed with assessments that are levied after a company has become insolvent. Both of the existing guaranty funds in Washington are financed with post-insolvency assessments.

The potential for a Kemper insolvency in 2005, and the sizeable dollar value of claims that could result from such a failure, support the need for pre-insolvency assessment. Additionally, unlike most other kinds of claims, workers' compensation claims are no-fault and the coverage generally is first-dollar. As a result, when a workers' compensation claim comes into a guaranty fund, money must be available to pay the claims immediately.

#### **Amount of assessment**

In its discussions concerning the amount of assessment necessary, the workgroup relied upon actuarial analysis by IBAW representatives and considered both the size of the assessment base and the potential impact of a Kemper failure on the fund. For the purpose of its analysis, the workgroup assumed that Kemper would fail during 2005. The workgroup considered potential assessments of between 2% and 4% of net direct written premium. With an assessment base of \$30 million in premiums, the following amounts would be generated during the first year of operation if the assessment was 2%, 3% or 4% of the premium written:

Assessment	Total \$\$ generated
2%	\$600,000
3%	\$900,000
4%	\$1,200,000

Even with a 4% assessment, the workgroup concluded that it may be necessary for the USL&H guaranty account to borrow money if Kemper failed during the first year of the fund's operation.

Most property and casualty guaranty funds in the United States have a maximum guaranty fund assessment of between 1% and 2%.<sup>25</sup> At 4%, Alaska currently has the highest maximum assessment for any guaranty fund in the United States.<sup>26</sup> Both accounts in the

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<sup>25</sup> See Appendix B.

<sup>26</sup> In 2004, in response to the Fremont Indemnity failure, the Alaska Legislature passed SB 276, which amended its guaranty fund statute to increase the assessment maximum on all three accounts from 2% to 4% of net direct

Washington Insurance Guaranty Association and the Washington Life and Disability Insurance Guaranty Association assess member companies 2% of the premium written.

The workgroup concluded that a USL&H guaranty account should levy a pre-insolvency assessment in an amount to be determined by the board, but not to exceed 3% of net direct written premium. Although the other accounts in the Washington Insurance Guaranty Association have a maximum assessment of 2%, the size of a Kemper failure and the small USL&H premium base for assessments makes a 2% assessment problematic. A pre-insolvency maximum assessment of 3% would provide sufficient funding to begin paying claims and enable the guaranty fund to borrow additional monies in the event of a Kemper failure during 2005. In addition, the group concluded that the post-insolvency assessment also should be determined by the board, but should not exceed 3% of net direct written premium. This would enable the board to assess the actual impact of a Kemper insolvency on the fund, and to lower the amount of the post-insolvency assessment below the maximum if deemed appropriate.

Additionally, the workgroup considered whether a limit should be placed on the size of the fund following collection of assessments, and concluded that the fund should not be permitted to grow beyond 4% of the aggregate net direct written premiums for the preceding calendar year on all authorized USL&H insurers. With an assessment base of \$30 million in premiums, the fund could not exceed \$1.2 million.

#### **Authority to borrow funds**

The workgroup believed it was imperative for a USL&H guaranty account to be able to borrow funds in the event of a shortfall of funds needed to meet an insurer insolvency. In reaching this conclusion, the workgroup considered the possibility of an early Kemper insolvency and the likelihood that the pre-assessment would not have produced sufficient funds to address the claims volume. The workgroup believed it was necessary to allow the USL&H guaranty account to pursue an unfettered choice of lenders, and therefore declined to identify potential lenders.

#### **Recoupment of assessments should be permitted**

The workgroup members agreed that insurers should be able to recoup assessments to the guaranty fund. The group considered whether assessments on insurers should be passed through to policyholders or whether the insurers should be permitted to take a premium tax offset for assessments.

Under both of the existing guaranty funds, insurers are entitled to offset guaranty fund assessments against premium tax. An insurer may take 20% of the amount of the assessment paid during a year for a period of five consecutive years following the year the assessment was paid.<sup>27</sup>

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written premiums. In addition, SB 276 included a spillover provision that requires the carriers to contribute up to 2% of their net direct written premiums to the other accounts if necessary.

[http://www.legis.state.ak.us/basis/get\\_bill\\_text.asp?hsid=SB0276Z&session=23](http://www.legis.state.ak.us/basis/get_bill_text.asp?hsid=SB0276Z&session=23)

<sup>27</sup> RCW 48.32.145 and 48.32A.125

The workgroup was divided on the best approach for insurers to recoup the assessments. Some members, including the representative from WIGA, supported a premium tax offset, while others supported a pass-through. Concerns were expressed over both approaches.

Although the workgroup's maritime industry representative did not oppose a pass-through of the assessment to policyholders, there was concern that a 3% rate increase could be difficult for small maritime employers to absorb. Some insurers and brokers raised concerns that a rate increase of 3% could make it difficult for them to compete in the marketplace with surplus lines carriers, mutual pools and other non-admitted carriers not regulated by the State of Washington. Additionally, if assessments were to be passed-through to policyholders, the guaranty fund would not collect a full year of assessments until 12 months after the law went into effect. If Kemper were to fail in the interim, the guaranty association would be required to borrow money to begin paying the claims.

At the same time, some USL&H insurers expressed concern over the premium tax offset, because the offset permits the insurer to recoup only up to 20% of the assessment each year for a period of five years. The insurers were concerned that by spreading the offset over five years, they would be losing the time value of their money. An additional concern is that the insurers may not be able to offset the entire 20% of the assessment each year, and that any unused premium tax credits would be permanently lost.

### ***Legislation to Create a USL&H Guaranty Account***

Members of the workgroup are working together to prepare a draft legislative proposal to create a USL&H guaranty account within the Washington Insurance Guaranty Association that reflects the group's recommendations. It is the intent of the workgroup members to submit the bill to the Legislature during the 2005 legislative session.

### ***Recommendations***

We recommend that the Legislature create a separate account in the Washington Insurance Guaranty Association to cover USL&H claims. To create this account, we recommend that the Legislature adopt provisions that would accomplish the following:

Assessments to finance the account would be levied against only admitted USL&H insurers.

Collect a pre-insolvency assessment that will continue post-insolvency. Beginning July 1, 2005, assess USL&H insurers in an amount to be determined by the board, but not to exceed 3% of net direct written premiums. Following an insolvency, assess USL&H insurers in an amount to be determined by the board, but not to exceed 3% of net direct written premiums. Permit the association to collect assessments until a maximum fund has been created that, according to the board, meets the financial needs of the fund, but not to exceed 4% of the aggregate net direct written premiums.

Permit the USL&H insurers to take a premium tax offset of up to 20% of the assessment for each of the five years following the assessment. A premium tax offset would permit the guaranty association to collect the annual assessments within 30 days after issuing notices,

rather than over a full year. Additionally, the other two accounts in the Washington Insurance Guaranty Association permit a premium tax offset, so an offset for the USL&H account would not require a different administrative process for the association.



# **Tribal Workers' Compensation Insurance**

## ***Background***

In Washington, industrial insurance must be obtained exclusively through the Department of Labor and Industries (L&I). Unless expressly excluded, the mandate to obtain industrial insurance through L&I applies to all employments that are within the legislative jurisdiction of the state.<sup>28</sup> Employments that are excluded from the mandatory coverage of Title 51 RCW are listed in RCW 51.12.020. These “optional categories” may voluntarily purchase industrial insurance through L&I, but are not required to do so.

Tribal governments are sovereign nations, and as such, they are not covered by Title 51 RCW and are not required to purchase industrial insurance from L&I for tribal-owned or majority-owned employments on tribal lands. Employees of tribal-owned or majority-owned employments that work off tribal lands must be covered by industrial insurance for that work.

Currently, tribal entities purchase workers' compensation in the commercial market or they self-fund their workers' compensation programs. Although Title 51 RCW specifies statutory requirements for industrial insurance, the commercial policies need not comply with these requirements. Most of the commercial policies are significantly similar to state industrial insurance, with one notable exception: claim appeals are adjudicated through the tribal court system of the respective tribe, rather than the industrial insurance board and state courts. Some of the commercial policies set claim limits that differ from state industrial insurance.

The Washington Insurance Guaranty Association Act expressly excludes workers' compensation insurance from guaranty fund coverage.<sup>29</sup> If a tribal workers' compensation insurer fails and cannot cover outstanding claims, the claims are likely to go unpaid and the employees are hurt. Under normal circumstances, the claims *do not* become the responsibility of the employer.

In 2004, the Legislature passed ESB 6158, which required the Office of the Insurance Commissioner to study the impact of excluding from guaranty association protection workers' compensation policies purchased on the commercial market by tribes and tribal employers.

## ***History in Washington***

Prior to the 1970s, tribes located within Washington State purchased industrial insurance from L&I. During the 1990's many Washington tribes still purchasing industrial insurance began purchasing tribal workers' compensation from private insurers.<sup>30</sup> Also, as far back as the 1980s, a small number of tribal entities chose to self-fund their workers' compensation programs, rather than participating in the state industrial insurance program.

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<sup>28</sup> RCW 51.12.010

<sup>29</sup> RCW 48.32.020

<sup>30</sup> Department of Labor and Industries

From the late 1970s to 1999, L&I considered tribal employers to be an “optional category” that could purchase industrial insurance from L&I on a voluntary basis. In 1999, L&I received an opinion from the Washington State Attorney General’s Office stating that tribal employers were not an “optional category” and L&I could not sell industrial insurance to the tribal employers without first entering into a formal written agreement with the tribes. At the time of the Attorney General’s opinion, only one tribe was purchasing industrial insurance through L&I. The remaining tribes self-funded or purchased workers’ compensation coverage in the commercial market. Following the Attorney General’s opinion, L&I discontinued offering industrial insurance to tribal employers on an optional basis.<sup>31</sup>

In April 2002, Legion and Villanova were placed into rehabilitation with the Pennsylvania Insurance Commissioner’s Office. On April 25, 2003, the companies were ordered into liquidation. At the time of their failure, these companies were heavy writers of tribal workers’ compensation insurance in the United States and wrote the majority of tribal workers’ compensation insurance in Washington State. Following the Legion and Villanova failure, it became clear that a number of outstanding claims would not be covered. Subsequently, Tribal First Insurance, a subsidiary of Affinity Insurance<sup>32</sup>, a California insurance brokerage firm that marketed Legion and Villanova policies, voluntarily assumed payment of the remaining twenty plus Legion and Villanova claims.

After Legion and Villanova were placed into rehabilitation in 2002, Washington Tribes formerly placed with these insurers for workers’ compensation were moved to Hudson Insurance Company, a foreign insurer. Today, Hudson Insurance Company is the only known commercial carrier selling first-dollar tribal workers’ compensation in Washington State.

### ***Issues Raised by Workgroup***

- What is the size of the tribal workers’ compensation market in Washington?
- What is the potential impact of future tribal workers’ compensation insurer insolvencies in the absence of guaranty fund coverage?
- Should tribal workers’ compensation receive guaranty fund coverage?
- What is the timing and what additional information is needed before this issue can be resolved?

### **Size of the Tribal Workers’ Compensation Market in Washington**

Currently, the following 29 tribes are recognized in Washington State: Confederated Tribes of the Chehalis Reservation; Confederated Tribes of the Colville Reservation; Cowlitz Indian Tribe; Hoh Tribe; Jamestown S’Klallam Tribe; Kalispel Tribe of Indians; Lower Elwha Klallam Tribe; Lummi Nation; Makah Indian Tribe; Muckleshoot Indian Tribe; Nisqually

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<sup>31</sup> Department of Labor and Industries

<sup>32</sup> <http://www.tribalfirst.com/index.htm>

Indian Tribe; Nooksack Indian Tribe; Port Gamble S'Klallam Tribe; Puyallup Tribe of Indians; Quileute Indian Tribe; Quinault Indian Nation; Samish Indian Nation; Sauk-Suiattle Indian Tribe; Shoalwater Bay Indian Tribe; Skokomish Tribal Nation; Snoqualmie Indian Tribe; Spokane Tribe of Indians; Squaxin Island Tribe; Stillaguamish Tribe; Suquamish Tribe; Swinomish Indian Tribal Community; The Tulalip Tribes; Upper Skagit Indian Tribe; and, Yakama Indian Nation.<sup>33</sup>

In recent years, many Tribes in Washington State have expanded their business enterprises to include casinos, bingo halls, economic development and municipal functions . Due to this rapid expansion of the tribal employment base, there is an increased need for tribal workers' compensation insurance coverage. It is also estimated that a majority of tribal employment consists of non-tribal and non-Native American employees.

Of the 29 recognized tribes in Washington, 24 purchase commercial tribal workers' compensation policies. Three of tribes are self-insured and two of the tribes have adopted limited industrial accident coverage.<sup>34</sup>

According to information obtained from Hudson Insurance Company, in 2003, Hudson wrote approximately \$8.5 million in premiums for tribal workers' compensation in Washington. In 2004, Hudson's premium volume was approximately \$10 million.<sup>35</sup>

### **Potential Impact of Future Tribal Workers' Compensation Insurer Insolvencies in the Absence of Guaranty Fund Coverage**

One of the issues the workgroup discussed was the impact of future tribal workers' compensation insurer insolvencies. Currently, the majority of tribal entities purchase workers' compensation policies on the commercial market. Additionally, only one insurer--Hudson Insurance Company--offers the policies. If Hudson Insurance were to become insolvent in the future, nearly all of the tribal market would be impacted. More concerning yet, all of the tribal employees who were covered under the policies and had pending claims would be without coverage or recourse. It is possible that some of the tribes, or the insurance brokerage firms through which the policies were marketed would voluntarily assume payment of some of the claims, but there would be no legal requirement for them to do so.

The workgroup discussed the possibility of tribal employers being able to purchase industrial insurance from L&I in the future. Industrial insurance purchased through the state is backed by the state fund, and does not need guaranty fund protection. Currently, L&I is examining the possibility that they will change the agency policy in the future and permit tribes to purchase industrial insurance on an optional basis.<sup>36</sup> Whether tribal employers would avail themselves of such an option is unclear. The workgroup received mixed messages from the tribal representatives that attended the meetings. While the tribal representatives agreed that

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<sup>33</sup> <http://www.goia.wa.gov>

<sup>34</sup> Brown & Brown

<sup>35</sup> Hudson Insurance Company

<sup>36</sup> Department of Labor and Industries

they would like to have the option to purchase industrial insurance from L&I, they also opined that few, if any, of the tribes would take advantage of this option.

In the current market, without tribal employers having the option to obtain industrial insurance through L&I, the impact of an insolvency of a tribal workers' compensation insurer could be devastating without guaranty fund coverage.

### **Guaranty Fund Coverage for Tribal Worker's Compensation**

The workgroup addressed whether, as a matter of policy, tribal workers' compensation insurance should receive guaranty fund coverage in Washington, and if so, whether it is feasible, given the current market and guaranty association structure.

As a general matter of policy, the workgroup agreed that, ideally, tribal workers' compensation insurance should be covered under a guaranty fund. However, the current market and guaranty association structure make this problematic, at best.

The size of the tribal workers' compensation insurance market in Washington is only \$10 million in annual premium volume. The market is too small to support a separate guaranty association or account. With only one commercial carrier in the market, the only carrier that would be paying assessments would be the carrier whose failure the fund would be in existence to cover. As soon as a failure occurred, the assessment base would disappear.

The workgroup concluded that in order to cover tribal workers' compensation under a guaranty fund, it would have to be combined with one of the existing accounts in the Washington Insurance Guaranty Association. The most logical account would be the USL&H account that the first workgroup recommended creating, because both USL&H and tribal workers' compensation are types of workers' compensation coverage.

Two problems were identified with inclusion of tribal workers' compensation in a USL&H guaranty account within the Washington Insurance Guaranty Association. First, the USL&H carriers and the Washington USL&H Assigned Risk Plan oppose inclusion of tribal workers' compensation in an account covering their risks. The USL&H carriers were concerned that their assessment base is only \$30 million and Hudson's premium volume is \$10 million. With such a proportionately large premium volume, the failure of Hudson would be devastating to the USL&H guaranty account and the carriers being assessed to support the account.

In addition to the USL&H market's opposition to inclusion of tribal workers' compensation in a USL&H guaranty account, Hudson Insurance Company also opposes inclusion in such an account. According to the General Counsel for Hudson Insurance Company, they would oppose any attempt to include them in a state guaranty fund. Hudson considers the USL&H risks and the tribal workers' compensation risks to be substantially different, and indicated that it would not be fair to include both risks in the same guaranty fund. If Hudson's participation was required by the Legislature, Hudson's General Counsel stated they would have to pass the assessments along to the purchasers, which would increase rates. Additionally, Hudson's General Counsel stated that if they were required to participate in a

guaranty fund, the company would have to re-evaluate whether it was cost effective to remain in business in Washington.<sup>37</sup>

### **Timing and Additional Necessary Information**

In view of the opposition to participation in a guaranty fund expressed by Hudson Insurance Company, the tribal representatives urged the workgroup to proceed with caution before pursuing a guaranty fund for tribal workers' compensation. The tribal representatives voiced concerns that forcing Hudson Insurance Company to participate in a guaranty fund could result in its withdrawal from the market, having a devastating impact on the tribal workers' compensation market in the state. Even if Hudson did not withdraw from the market, Hudson could raise its rates to cover the assessments, which could have a negative impact on many tribal employers. Additionally, the tribal representatives believed that too few tribal representatives participated in the discussion and meaningful consensus could not be reached without broader representation from all tribes.<sup>38</sup>

All of the workgroup members agreed that guaranty fund coverage for tribal workers' compensation is an important issue that bears further consideration. With one notable exception, the workgroup members believed that it would be precipitous to attempt to create guaranty fund coverage for tribal workers' compensation during the 2005 legislative session. They urged the participants to continue meeting on the issue and to obtain wider participation from Tribes not currently represented in the meetings. The workgroup believed that it was imperative to involve Hudson Insurance Company in the process to avoid any unintended negative impact on the market.

One of the workgroup members strongly believed that the creation of a tribal workers' compensation guaranty fund should be pursued during the 2005 legislative session. That member suggested that coverage for tribal workers' compensation should be folded into legislation creating a USL&H guaranty account.

### **Recommendations**

We recommend that the stakeholders who participated in the workgroup meetings continue to study the idea of creating guaranty fund coverage for tribal workers' compensation during 2005. Additionally, we recommend that the participants include Hudson Insurance Company and increased tribal representation.

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<sup>37</sup> Mr. Peter Lovell, General Counsel for Hudson Insurance Company

<sup>38</sup> Brown & Brown, an insurance brokerage firm that participated in the workgroup meetings, extended invitations to the meetings to a number of the tribes that purchase tribal workers' compensation policies from Hudson Insurance Company. Despite these efforts, only three tribes were represented at the workgroup meetings.

# **Workers' Compensation Insurance for Title 51 "Optional Category" Employments**

## ***Background***

Title 51 RCW applies to all employments that are within the legislative jurisdiction of the state and mandates that those employments obtain industrial insurance through L&I. RCW 51.12.020 identifies "optional category" employments that are expressly excluded from the general Title 51 RCW mandate. The following "optional category" employments may voluntarily purchase industrial insurance through L&I, but are not required to do so:

(1) Any person employed as a domestic servant in a private home by an employer who has less than two employees regularly employed forty or more hours a week in such employment.

(2) Any person employed to do gardening, maintenance, or repair, in or about the private home of the employer. For the purposes of this subsection, "maintenance" means the work of keeping in proper condition, "repair" means to restore to sound condition after damage, and "private home" means a person's place of residence.

(3) A person whose employment is not in the course of the trade, business, or profession of his or her employer and is not in or about the private home of the employer.

(4) Any person performing services in return for aid or sustenance only, received from any religious or charitable organization.

(5) Sole proprietors or partners.

(6) Any child under eighteen years of age employed by his or her parent or parents in agricultural activities on the family farm.

(7) Jockeys while participating in or preparing horses for race meets licensed by the Washington horse racing commission pursuant to chapter 67.16 RCW.

(8)(a) Except as otherwise provided in (b) of this subsection, any bona fide officer of a corporation voluntarily elected or voluntarily appointed in accordance with the articles of incorporation or bylaws of the corporation, who at all times during the period involved is also a bona fide director, and who is also a shareholder of the corporation. Only such officers who exercise substantial control in the daily management of the corporation and whose primary responsibilities do not include the performance of manual labor are included within this subsection.

(b) Alternatively, a corporation that is not a "public company" as defined in RCW 23B.01.400(21) may exempt eight or fewer bona fide officers, who are voluntarily elected or voluntarily appointed in accordance with the articles of incorporation or bylaws of the corporation and who exercise substantial control in the daily management of the corporation, from coverage under this title without regard to the officers' performance of manual labor if the exempted officer is a shareholder of the corporation, or may exempt any

number of officers if all the exempted officers are related by blood within the third degree or marriage. If a corporation that is not a "public company" elects to be covered under subsection (8)(a) of this section, the corporation's election must be made on a form prescribed by the department and under such reasonable rules as the department may adopt.

(c) Determinations respecting the status of persons performing services for a corporation shall be made, in part, by reference to Title 23B RCW and to compliance by the corporation with its own articles of incorporation and bylaws. For the purpose of determining coverage under this title, substance shall control over form, and mandatory coverage under this title shall extend to all workers of this state, regardless of honorary titles conferred upon those actually serving as workers.

(d) A corporation may elect to cover officers who are exempted by this subsection in the manner provided by RCW 51.12.110.

(9) Services rendered by a musician or entertainer under a contract with a purchaser of the services, for a specific engagement or engagements when such musician or entertainer performs no other duties for the purchaser and is not regularly and continuously employed by the purchaser. A purchaser does not include the leader of a group or recognized entity who employs other than on a casual basis musicians or entertainers.

(10) Services performed by a newspaper carrier selling or distributing newspapers on the street or from house to house.

(11) Services performed by an insurance agent, insurance broker, or insurance solicitor, as defined in RCW 48.17.010, 48.17.020, and 48.17.030, respectively.

(12) Services performed by a booth renter as defined in RCW 18.16.020. However, a person exempted under this subsection may elect coverage under RCW 51.32.030.

(13) Members of a limited liability company, if either:

(a) Management of the company is vested in its members, and the members for whom exemption is sought would qualify for exemption under subsection (5) of this section were the company a sole proprietorship or partnership; or

(b) Management of the company is vested in one or more managers, and the members for whom the exemption is sought are managers who would qualify for exemption under subsection (8) of this section were the company a corporation.<sup>39</sup>

These "optional category" employers can choose to purchase industrial insurance from L&I for their employees, they can purchase other commercial insurance in lieu of industrial insurance, they can self-fund or they can go without insurance.

### ***Issues Raised by Workgroup***

- What is the size of the "optional category" market?

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<sup>39</sup> RCW 51.12.020

- For the employers that decline to purchase industrial insurance through L&I, are they purchasing any insurance to cover their employees and if so, what kinds of insurance?
- Do the kinds of insurance purchased by “optional category” employers have guaranty fund protection?

## **Size of the “Optional Category” Market**

The workgroup discussed the size of the “optional category” market and concluded that it was impossible to determine the actual size of the market, because some of the employers do purchase industrial insurance through L&I, some go without coverage, and many others purchase a combination of policies in lieu of industrial insurance. The general sense from L&I was that these employers represent a small segment of the private insurance market.

## **Kinds of Insurance Purchased by “Optional Category” Employers**

Members of the workgroup opined that most “optional category” employers purchase some combination of disability insurance, health insurance and life insurance. OIC contacted three associations representing “optional category” employers to confirm this information.

According to the Washington Contract Loggers Association, most logging business owners purchase a combination of short-term and long-term disability insurance, and life insurance for themselves.<sup>40</sup> Some owners also purchase health insurance from a health care service contractor. The association indicated the premium for such a package is very reasonable and owners would not be able to obtain industrial insurance from L&I at the same cost.

Emerald Downs provided information on insurance purchased for jockeys.<sup>41</sup> Emerald Downs purchases disability policies to cover the jockeys on race days.

The Building Insurance Association of Washington (BIAW) represents contractors and related businesses. According to the BIAW<sup>42</sup>, they offer a disability policy for business owners. It is the understanding of the association that most of the business owners, who decline to purchase the disability policy, purchase health insurance for themselves.

## **Guaranty Fund Protection**

The workgroup examined the question of whether guaranty fund protection exists for the kinds of insurance purchased by “optional category” employers in lieu of industrial insurance. The workgroup concluded that the Washington Life and Disability Insurance Guaranty Association already covers claims arising from disability and life insurance policies.<sup>43</sup>

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<sup>40</sup> Bill Pickell, Washington Contract Logger’s Association

<sup>41</sup> Dick Caragall, Emerald Downs

<sup>42</sup> Tom Kwieciak, Building Insurance Association of Washington

<sup>43</sup> RCW 48.32A.005 et seq.



## ***Recommendation***

We recommend that no action be taken at this time to create additional guaranty fund protection for insurances purchased by “optional category” employers in lieu of industrial insurance.

### USL&H Workgroup

<b>Workgroup Member</b>	<b>Affiliation</b>
Bill Daley	Office of the Insurance Commissioner
Ruth Ammons	Office of the Insurance Commissioner
Marshall McGinnis	Office of the Insurance Commissioner
Dale Newell	Insurance Brokers & Agents of the West
Stewart Sawyer	Insurance Brokers & Agents of the West
Gordon Baxter	Labor
Charles Glass	Washington Assigned Risk Plan
Stephen Miller	Washington Insurance Guaranty Association
Andrew Posewitz	Todd Shipyards
Jim Hannah	Liberty Northwest Insurance
Chris Engstrom	PointSure
Frank Romero	Department of Labor & Industries

### Tribal Workers' Compensation and "Other Categories" Workgroup

<b>Workgroup Member</b>	<b>Affiliation</b>
Bill Daley	Office of the Insurance Commissioner
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Amber Carter	Association of Washington Business
Veronica Amen-Williams	AIG
Dale Newell	Insurance Brokers & Agents of the West
Owen Linch	Joint Council of Teamsters
Jeff Martins	Brown & Brown
Korrin Murphy	Brown & Brown
Stephen Miller	Washington Insurance Guaranty Association
Frank Romero	Department of Labor & Industries
Tammy Turner	Department of Labor & Industries
Mike Taylor	The Tulalip Tribes
Lee Topash	Tulalip Casino
Toni Repetti	Skagit Valley Casino
Phillip Brooke	Muckleshoot Indian Tribe

The National Conference of Insurance Guaranty Funds had prepared the following summaries, by provision, of the 2004 property and casualty insurance guaranty association acts of the various states and U.S. territories:

<http://www.ncigf.org/guaranty/datasheets/Excluded%20Lines%20of%20Business.xls>

<http://www.ncigf.org/guaranty/datasheets/Claim%20Parameters.xls>

<http://www.ncigf.org/guaranty/datasheets/Info%20on%20Assessment%20-%20Assessment%20Account%20Structure.xls>

<http://www.ncigf.org/guaranty/datasheets/Info%20on%20Assessment%20-%20Other.xls>

<http://www.ncigf.org/guaranty/datasheets/Explanatory%20Notes.doc>